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GEORGE WASHINGTON UNIVERSITY

NAVY GRADUATE COMPTROLLERSHIP PROGRAM

MANAGEMENT AND FINANCIAL CONTROL OF SHORE FACILITIES

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PREFACE

The original title of this paper was intended to be, "MANAGEMENT CONTROL AT BUREAU LEVEL", a comparison of the various methods of financial control used by the principal material Bureaus of the Navy. The purpose was simply to gain familiarity with the procedures in use in budgeting for and obtaining funds for the many and various programs. This basic knowledge could be of value to a candidate for a comptroller's job.

However, after a brief amount of reading, it was apparent that each Bureau's instructions were basically the same, although the format differed. At that point, I decided that a sample of the Bureau of Ship's control over its field activities would suffice, with an inspection of the general trend in implementing TITLE IV. Fortunately, under the Facilities Branch of the Bureau of Ships, activities operate under both the Navy Industrial Fund, and the Appropriation System of Accounting, which comprise the two basic structures for financial control in the Navy.

At this point I want to express my appreciation to Commander J.C. McCarthy of the Navy Facilities Branch, Mr. R.D. Simmans, Assistant Comptroller for Budget, Bureau of Ships, Mr. B. D. Brocksmith, Field Accounting Branch, Navy Comptroller's Office, Captain R.K. McKay, Comptroller, New York Naval Shipyard and J. Grossman, Assistant Comptroller, New York Naval Shipyard who generously helped clarify and expand my understanding of this subject.

CHAPTER I

INTRODUCTION

Comptrollership. -- Since the introduction of the comptrollership concept in the Department of Defense in August 1949, the word "Comptrollership" and all that it implies has had many meanings and reactions to different people. One commanding officer of a defense industrial activity in 1954 remarked to some members of the Cooper Committee, "No comptroller is going to control me." To him the idea suggested that his prerogatives as commanding officer were in jeopardy of being usurped by some one whose function he did not understand. This distorted view could well have been supported by an equally inappropriate remark. In a talk before the current Navy Graduate Comptrollership Class one of the civilian speakers from the Bureau of Ordnance, in a side remark said, "This is the greatest job-grab in years".

Although both statements have a remote element of truth, they are far from the original intentions expressed in the Title IV section of Public Law 216. However, they are typical of the suspicious fears of some, and the empire building aspirations of the others throughout the management sphere of the Navy. For this reason it would be well to examine the conditions that centered the attention of Congress, special commissions and the Secretary of Defense on the necessity for streamlining the business management of the military establishment in the period following World War II.

Background 1945-1949.-- Unlike similar post-war periods of the past when the armed forces became an insignificant fraction of their size in wartime, the uneasy and continuing status of the "Cold-War" made in necessary to maintain an Army, Navy and Air-Force of unheard of proportions. With this predominating thought in mind, and with a view toward the effective utilization of our decreasing resources, the objective of promoting economy and efficiency in our national military establishment became paramount.

A vast amount of evidence was collected by the military services, special commissions and Congress which focussed attention on hundreds, if not thousands, of instances of poor management and ineffective control. Generally these were "after the fact" revelations, and while responsible officials were required to explain, overall performances did not improve to a marked degree. For example, in 1945 while the Navy was investigating the tremendous problem of cataloguing millions of separate electronic spare parts, spare parts manufactured in 1926 were found in storage at the Mare Island Navy Yard.[1] If instances as this were typical, and they were, programs for the future had to insure that we were not buying spares we already possessed. This pointed to a basic and vital element necessary for improved management, an accurate and properly controlled inventory program. This problem

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1. Testimony of Mr. W. J. McNeil, Special Assistant to the Secretary of Defense, Hearings Before Sub-Committee of the Committee on Appropriations United States Senate, 80th Congress, First Session p. 17.

of inventory control was, and still is, one of vast magnitude both in relation to operating performance and dollar investment.

Similarly in another important area, that of proper utilization of funds, poor planning and poor performance were frequently highlighted at appropriation hearings. Senator L. P. Saltonstall of the Eightieth Congress cited these few cases:

> (1) Project Order Number 1-47-Research Navy for $25,000, issued July 1, 1946 for development of special devices, had $124,885 expended against it as of December 31, 1947.
>
> (2) Investigation revealed that it was common practice to develop the great bulk of project orders in May and June of each fiscal year in order to avoid losing money that had been appropriated. A few glaring errors of this widespread practice in the Navy Budget were:
> (a) Marine Corps committed 82% of project orders in June 1947;
> (b) Bureau of Medicine and Surgery committed 71.2% of its project orders in June 1947;
> (c) Research Navy, committed 33% of its project orders in June 1947;
> (d) Bureau of Yards and Docks committed 25% of its project orders in June 1947.[2]

The specific subject of project orders will be discussed later in this paper. For the present, it is sufficient to note that while progress has been made in more properly utilizing project orders, Congress is not the least bit satisfied, and still very suspicious of the intent behind a large percentage of those issued.

In the meantime, while evidence of this nature was being

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2. Hearings before the Sub-Committee of the Committee on Appropriations United States Senate, Eightieth Congress, First Session.

collected, a continuing study was made under the sponsorship of Secretary Forrestal, with the objective of improving the business management of the Navy. This role is briefly described by Mosher:[3]

> A principal stimulator in this movement, as it may properly be called, was the military establishment and its sub-departments, particularly the Departments of the Navy and Air Force. The Department of Defense as a whole still occupies a place among the leaders in the development of the new approach. The Navy in 1946 had presented its fiscal year 1948 budget in two alternate forms, one representing the traditional basis of Navy appropriations, the other on a program basis. After some argument with the Bureau of the Budget, both forms were submitted to Congress. However, the appropriation committees of the newly elected eightieth Congress chose to ignore the new-style proposal. Subsequently, the idea of reorganizing appropriation structures along more rational lines was pushed from the level of the newly formed Department of Defense, notably by Secretary Forrestal and W. J. McNeil, his special assistant. This group, pressing its view on certain key Congressmen and Senators, and later upon Mr. Hoover himself, contributed to the emphatic views of the Hoover Commission on a revised budgeting system.
>
> As described in Chapter II, the Congress in 1949 made the performance budget mandatory for the entire Department of Defense. Already, however, the newly created Department of the Air Force, under the necessity and with the opportunity of building a new budget system for itself, had set up a program or performance type budget. The Navy followed in its budget for fiscal year 1951. At the beginning of fiscal year 1952, the Army revised its appropriations to complete the change-over in appropriations structure of the military departments.
>
> In spite of the apparent simplicity of the concept and in spite of the modifications in budgetary classifications and appropriations, there is still much question as to whether these departments in fact have performance budgets. There is even some question whether what they have done is in the direction of performance budgets. As will be shown, the present budget structures and systems of the Army, Navy, and Air Force differ markedly from each other. Obviously, the term means different things to different people.

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3. Frederick C. Mosher, Program Budgeting: Theory and Practice, (New York: American Book - Stratford Press, 1954), p.80

A key figure in this campaign was Mr. Ferdinand Eberstadt, long time friend and business associate of Secretary of Defense Forrestal. Besides having a distinguished career in both the law and business fields, Mr. Eberstadt had been a leading consultant on governmental problems since 1929. He had been Owen D. Young's assistant at the 1929 Reparations Conference. During the war he was Chairman of both the Army and Navy Munitions Board and the War Production Board. Later he presented the Eberstadt Report for the Secretary of the Navy in 1945, which gave the Navy's views in the losing fight against the National Security Act of 1947. Finally he was to be Chairman of the National Security Organization Task Force of the Hoover Commission.

The evidence presented Mr. Eberstadt's Committee by Secretary Forrestal, Mr. McNeil, other Secretaries of the Defense Establishment, and one hundred sixty other prominent witnesses, clearly indicated the need for improving management in the Department of Defense. Typical of the evidence presented was related to the various sources of appropriations at the Bethesda Naval Medical Center. Appropriations came from at least twelve different sources. To determine the cost of operating the hospital, it would have been necessary to go through a maze of intricate and involved accounting. At no one point in the Navy Department could one find in a single entry what it cost to run this operation, particularly in time to be of value to top management. Facts such

as these, finally received the attention they merited, primarily because of prestige of Mr. Hoover.

Shortly thereafter, at Senator Byrd's request, Mr. Eberstadt drafted the report which ultimately contained title IV.[4] In January 1949, when it was presented to Congress, for this purpose of this paper, it was divided into two parts. The first section dealt with reorganizing the Department of Defense in order to strengthen the powers of the Secretary of Defense. The second part dealt with provisions for improving economy and efficiency by reorganizing budgetary and fiscal procedures. Due to the intense controversies centering about the powers of the Secretary of Defense, and the related programs of the seventy group Air-Force, and scrapping the navy's supercarrier, Title IV provisions for fiscal and budgetary reforms received relatively little Congressional attention.[4] In effect, the Congressional Committees listened and unanimously agreed with the recommendations presented.

Public Law 216. -- On August 10, 1949 the long sought goal of Mr. Hoover, Mr. Forrestal, Mr. Eberstadt, and Mr. McNeil was finally realized when the National Security Act Amendments of 1949, Public Law 216 - 81st Congress were approved. The main provisions of

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4. U.S. 83rd Congress First Session Hearings before Preparedness Committee No. 3 of the Committee on Armed Services United States Senate, IMPLEMENTATION OF TITLE IV NATIONAL SECURITY ACT OF 1947, AS AMENDED, Nov. 2, 1953.

TITLE IV section, as summarized by Senator Tydings were:

> The title contains various provisions, all of which are intended to implement the authority over the budgets of the military services conferred upon the Secretary of Defense under Section 202(a) of the National Security Act. The title provides, among other things, for the appointment of a Comptroller in the Office of the Secretary of Defense, for the appointment of Comptroller in the military departments and for comparable organization and procedures in budgetary and fiscal matters in the office of the Secretary of Defense and in the Military Departments.
>
> The title also provides for the presentation of budgets in a form that clearly reflects the costs of performing the activities of the Department of Defense and for the conduct of authorized programs in the same manner. It contains authority for certain program adjustments, and gives the Secretary of Defense control over requests for legislation which would authorize new appropriations. It also contains provisions designed to prevent overdrafts and deficiencies. Among its other provisions are authority for the organization of inventories of the military departments into stock funds, for the operation of industrial and commercial type activities as integral working units on the basis of adequate capital structure, for industrial management funds to facilitate the carrying out of joint and special operations, for uniform terminologies, classifications, reporting systems and accounting procedures, and for reports of property.
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> Whatever may have been the differences of view on other matters expressed by those who testified before the Armed Services Committee of the Senate, there seems to have been unanimous agreement that the Secretary of Defense should have effective authority and control over military budgets and over fiscal procedures. This authority is conferred upon the Secretary of Defense by the provisions of Section 202(a). The new TITLE IV is intended to implement it. Its provisions are designed to place the operation of the Defense Establishment on a sound budgetary and fiscal management basis. [5]

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5. U.S. 81st Congress 1st Session - Senate Report No. 366, Calendar 356, National Security Act Amendments of 1949, p. 10.

Two subjects, performance budgeting and industrial funds, will be of continuing interest for the remainder of this paper. For that reason both will be defined at this point to aid in the presentation.

A performance budget is one in which all costs incidental to the accomplishment of a specific job are consolidated into an identifiable project, with projects logically grouped into primary functions, and in which, insofar as possible, fiscal and management responsibility are parallel. It separates current operating expenses from capital expenditures. It is designed to focus attention on the general character and relative importance of the work to be done, or the service to be rendered, rather than the equipment, supplies, and personal services required. Simply, it is budgeting for things to be done rather than things to be bought.

Working Capital Funds are of two types, industrial or commercial funds, and stock funds.

Industrial funds are devices for financing industrial type activities whereby cash and inventories are invested as capital for the operation of the activities on a basis comparable to private business. These funds are authorized under section 405 of Title IV. This authorizes the Secretary of Defense to provide capital for industrial and stock funds for capitalizing the inventories on hand and, with the approval of the President, by transfer, until December 31, 1954 from unexpended balances of any appropriations of the military departments not carried to the surplus fund

of the Treasury. Direct appropriations are also authorized, if necessary, to provide capital.

A stock fund is a working capital fund established to finance the acquisition and maintenance of materials, supplies and equipment for sale within a military department or to other military departments. It operates in a fashion similar to a privately owned merchandizing organization. The Bureau of Supplies and Accounts has successfully operated a stock fund for over the past thirty-five years. As a result, the Navy had an advantage over the other military services in adopting its organization to the requirements of Title IV, because its inventory of the thousands upon thousands of items accounted for under the naval stock fund was clear, definite, positive and prompt, both as to item and dollar value.[6]

Implementation 1949-1953. -- The end of the fighting in Korea in effect marked the termination of the first phase of implementing Title IV provisions of the National Security Act of 1949. During the first four years, progress in implementing the various provisions were far behind what Mr. Eberstadt and Mr. McNeil had hoped and envisioned. This inertia was due to any number of reasons.

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6. Testimony Mr. W.J. McNeil, Assistant Secretary of Defense, Hearings Before the Preparedness Subcommittee No. 3 on the Committee on Armed Services, United States Senate, Eighty-Third Congress First Session, Nov. 2, 1953, p. 127.

As noted before, Title IV was relatively unnoticed by either Congress or the public.[7] In less than a year after the bill had been approved, the Korean affair interfered with the orderly transition. Lastly, within the Military Establishment many vested interests were not too anxious to vigorously implement this changeover, especially when attention rightfully had to be focussed on the essential task of conducting the war.

In the meantime, budgetary planning and execution reverted to a familiar pattern during times of crisis. During 1951, the basic Navy appropriation of $4,076,000,000 mushroomed to $12,252,000,000 with supplemental appropriations before the year was ended. The second year a $14,761,000,000 appropriation was not sufficient, requiring a supplemental of $819,000,000, and an urgent deficiency of an additional $39,000,000 to meet expenses. However, in order to be fair, it is well to recall that the 1950 budget was vigorously protested by all our naval leaders. That inadequate budget had forced us to inactivate ships in 1949 through the spring of 1950. Several months later we were taking these same ships out of mothballs for urgent use in the Pacific.

Despite all this, definite progress was made in implementing some of the main provisions of Title IV. Comptroller organizations had been established in most bureaus and offices, and in many field activities including shipyards, field offices of the

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7. Elias Huzar, The Purse and the Sword p. 177., (Ithica, New York, Cornell University Press, 1953)

Military Sea Transportation Service, the Naval Powder Factory, some ordnance plants and in three naval districts. The Navy Comptroller had authority and responsibility in all financial matters. Directives, policy statements, and instructions in the various comptroller areas, such as disbursing, cost accounting, appropriation accounting were covered in volumes of the Navy Comptroller Manual, and were binding on the entire Naval Establishment.

In the second significant area, the Navy adopted the Performance budget reducing the total number of appropriations from 48 to 21. The performance budget focussed attention on programs, especially on: (1) Objectives to be attained, (2) cost, and (3) accomplishment. This particular move to the Performance budget has been controversial because the bases for primary classification of appropriation titles were quite different between the Navy on the one hand, and the Army and Air Force on the other. The Navy moulded its structure around the existing organization structure of its bureau system. This in effect brought appropriation and management responsibility close together.

Mosher who believes that the Army and Air Force concept more closely approaches the true performance budget has this to say about the Navy's Budget:

> Each bureau was given one or more appropriations over which it has virtually exclusive jurisdiction and which, together, are roughly coextensive with its functions and responsibilities. The fundamental basis, therefore, is organizational rather than programmatic;

> the result is a classification that is functional in the same degree that the organization of Navy bureaus is functional. But the actual organization of the bureaus is more the product of history and tradition than of a logical analysis and division of functions. They could be described more accurately as units distinguished by subject matter and technical specialism, than by function or program. The second level of Navy classification - the breakdown of appropriations into budget activities - represents more of a functional emphasis than does the first. As a result, many of the same "activities" appear under different bureaus and applicable to different subject matter. Many of the appropriations include for example, the activities of procurement, maintenance and operation, industrial mobilization, research and development, and others.[8]

Mosher's reservations about the classification of naval programs are pinpointed to two principal exceptions in an Article by Commander Charles A. Blick:

> The underlying philosophy of the performance budget is to parallel management responsibility with fiscal responsibility. Exceptions to this general rule are military personnel, and service wide operations. In general, technical bureaus are involved in the fiscal affairs of only those activities over which they have fiscal control.[9]

The third major area of conversion during the period between 1949 and 1953 was in shifting to the Navy Industrial Fund at three shipyards, three ordnance plants, the Military Sea Transportation Service, and various smaller printing, research, and clothing activities. In addition three more shipyards were in the

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8. Mosher, op. cit. p. 85

9. Department of the Navy, Bureau of Supplies and Accounts, Commander Charles A. Blick, "Performance Budget for the Department of the Navy". Monthly Newsletter, February, 1950, p.5.

process of conducting surveys before shifting over to the Naval Industrial Fund in the early part of 1954. Spectacular improvements were promptly achieved by the Military Sea Transportation Service which were proudly acclaimed as typical of what to expect as a result of the changeover.

At this time in the fall of 1953, two committees were formed to evaluate and advise in the progress made in implementing Title IV. The first committee was headed by Senator Flanders, met in November, 1953. It reviewed the basic legislation for soundness, and generally proded all three military services toward a more rapid implementation of the remaining provisions of Title IV. It is significant to note that all officials interviewed, from Secretary Wilson on down, agreed unanimously on the improved management features of Title IV. The Navy had made far more progress than any other military service, and had the good fortune to avoid the notoriety which attended the Army's ammunition shortage in Korea, and the Air Force's free issue of gasoline to civilian air carriers.

The second committee was appointed by Secretary Wilson, became known as the "Cooper Committee", after its chairman, Charles P. Cooper. It organized into about sixteen or more working groups, each specializing in a specific problem area in the field of military comptrollership. Inventories, Industrial Activities, Fiscal Training, and Fiscal Organization and Procedures

are typical of the fields covered. The groups were made up of eminent leaders in the business and academic world. The reports of their surveys have been used extensively in extending the scope of comptrollership throughout the Military Establishment.

Subsequent to 1953, the Navy accelerated its program to include all shipyards and the Repair Base, San Diego as Navy Industrial Fund Activities. This represented a cash allocation of $140,900,000, and an annual volume of business of $717,000,000. Other ordnance activities were added, and at present a preliminary survey is being conducted prior to installing it at the first Naval Air Station at Quonset Point, Rhode Island.

CHAPTER II

SHORE FACILITY PROGRAM

Budgeting for Facility Programs. -- The purpose of this chapter is to examine the procedures and techniques employed by field activities and fleet activities of the Navy in budgeting for and obtaining funds from the Bureau of Ships for the various facility programs. The programs that will be covered, namely: (1) Plant Equipment Program, (2) Major Non-recurring Maintenance Program, and (3) Minor New Construction and Improvement Program, are financed from expenditures under the appropriation "Ships and Facilities, Navy, Subhead 11."

The immense scope of the management control problem confronting the Facilities Division in the Bureau of Ships can be partially understood by simply reading the lists of addressees under its management control. It contains a total of one hundred seventeen activities which include eleven naval shipyards and nine research laboratories. These activities are broken down into two main categories; (1) those activities which are field units of the Bureau of Ships, such as the shipyards, laboratories, repair facilities, and the repair departments of the many naval stations. All these are field units, reporting directly for management, fiscal and technical control; to the Bureau of Ships, (2) the fleet activities, whose primary mission is to support the units of the three main fleets. Typical of the activities in this group are

the Submarine Base, New London, Connecticut, Commander Service Force, United States Pacific Fleet, the Ship Repair Facility, Yokosuka, Japan, and Naval Base, Subic Bay, Philippine Islands. These activities report to the Bureau of Ships for management and fiscal control via their fleet commanders. However, unlike Ship overhaul funds which fleet commanders are delegated to control within their commands, shore facility money is administered by the Bureau of Ships on the recommendations of the fleet commanders.

Procedure for Submitting Requests. -- Each activity submits annually a list of its requirements arranged in priority order, within categories, complete with justifications. For the purpose of classification, three categories are employed:

Category A - Items essential for current operations

Category B - Items desirable for current operations

Category C - Items required in event of mobilization

Items in Categories "A" and "B" will be approved for procurement as accomplishment within availability of funds. Items in these categories for which there are insufficient funds will be used as estimates for future requirements; therefore each activity will include in its annual submission, items desired to be funded during the fiscal year beginning in July, and items to be used as budget estimates for the following fiscal year. Items in Category

"C" will be used for mobilization planning and estimating.[11]

This is a fine objective, but unfortunately in recent years, funds for other than routine and minimum maintenance have been mighty difficult to obtain. There are literally thousands of instances annually where requests for funds for recurring repairs, major maintenance, and replacement of obsolete machinery and equipment have been ignored year after year. For example, in the New York Naval Shipyard, repairs to the overhead crane tracks in one of the large shops was deferred for thirteen years until this current year. The reason for authorizing accomplishment this year was that it could no longer be safely deferred, an opinion which Commanding Officer pointedly indicated in a letter to the Bureau of Ships. Similarly, in both the New York and Norfolk Shipyards, the building ways have not been painted, or in any way preserved since 1944. Unlike the crane tracks these are not vital since they are not being utilized. However, in event of mobilization, these will be but two of a long list of urgent and vital items to be accomplished overnight at a cost that undoubtedly will be staggering. In this respect it appears that Comptrollers of the future will be hard put to avoid the huge supplemental appropriations that may be forthcoming.

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11. Manual for Administration of Facility Programs at Field and Fleet Activities, NAVSHIPS 250-770, April 1956, p. 8.

Project Orders and Allotments. -- Funds are provided by means of allotments or project orders. Allotments are generally straightforward and well understood, so no further elaboration is required at this point. However, project orders have recently been the subject of a close and critical inspection by auditors of the General Accounting Office because of widespread and continuous abuse of this device.

The following are the purposes for which project orders are issued:

(1) Manufacture, building, construction, fabrication, or assembly of structures, equipment or other property.

(2) Research and development projects.

(3) Improvements to structures, equipment or other property by modification, alteration, renovation, conversion, overhaul or restoration.

(4) Major repairs to or replacements of structures, equipment or other property.

Project orders will be issued for those projects which can be started during the fiscal year and will be accomplished in a substantial amount by station labor

Project orders may not be issued for the following:

(1) Routine, recurring maintenance and operation of activities, equipment or grounds.

(2) Education, training, subsistence, storage, welfare, transportation or communications when any of these purposes is the primary object.[12]

The original intent of project order was to place Naval industrial units in a better position to perform some of the complicated tasks which required detailed planning and execution. It was found desirable to give naval activities additional time to complete these tasks over and above that needed for obligating allotments. It is an excellent device for this purpose. However, through the years, it has been frequently employed for obligating funds just before the June 30 deadline on allotments, at which date unobligated funds would revert back to the Treasury.

Obviously this interferes with intent of Congress in exercising close control over appropriated funds, and commits large funds that would normally revert to the Treasury. For this reason the General Accounting Office is now conducting an extensive audit of this area. As yet there is no indication of the final decision, but undoubtedly Congress will require much tighter control in the future. The Navy Comptroller has issued two instructions in the past year ordering all commands to take decisive action to insure the validity of all obligations and expenditures against project orders. Similar warnings were issued to prevent overobligation and overexpenditure of allotments by the now famous Section 1311. Commanding Officers are subject to suspension

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12. Naval Comptrollers Manual, paragraphs 023400-023415.

from duty without pay, or removal from office; and upon conviction a fine of not more than $5,000, and imprisonment for note more than two years, or both.[13] To date only administative action has been taken in cases of this nature, but the veiled threat is apparent to even those who may be indifferent.

Plant Equipment Program. -- There are many programs sponsored by the various bureaus and offices of the Navy which help the average shore station carry out its missions. Primarily for the purpose of familiarization with the procedures and special provisions three of prime importance to Bureau of Ships activities have been selected for inspection. These are:

a. Plant Equipment Program

b. Major Non-Recurring Maintenance Program

c. Minor New Construction and Improvement Program

The first, the Plant Equipment Program, breaks down into three categories which are based primarily on the unit cost of an item, and the total cost of a specific transaction. In the first class a Commanding Officer has authority to spend up to $10,000 in one transaction providing the initial unit cost of the items procured is less than $100. This is charged to the station's maintenance and operation allotment, or to overhead, in the case of a Naval Industrial Fund Activity. This simply means that if an activity wanted to procure 100 typewriters at $99 each, it would be entirely

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13. Naval Comptrollers Manual, Volume 2, Appendix A.

free to do so, providing the balance of the allotment is sufficient.

In the next class, the initial unit cost is between $100 and $1,000 while the total for the individual transaction remains at $10,000. Again the activity is free to purchase if funds are available. However, these requirements should be anticipated and included in the integrated priority list of its needs that is submitted annually to the bureau prior to May for the next two fiscal years. Detailed justifications are not required unless the total is in excess of normal requirements. In this case full explanation should accompany the integrated priority list. Navy Industrial Fund Activities have a facilities allotment established by the Bureau for items costing between $500 and $1,000. These allotments will also be used to clear APA material from stock to plant use. Items costing less than $500 are termed "minor property", and are charged to overhead.

In the third category are items whose initial cost exceeds $1,000 or where the total specific transaction exceeds $10,000. These requirements for the next two years are required with the previously mentioned integrated priority list too. As funds are made available by the Bureau, letter notification is made with accounting instructions. This either charges a local facilities allotment set up for this purpose, or in event the Bureau procures the material, it will be charged against Bureau funds.

Here is an area that is loaded with inconsistencies. If

APA or "free issue" materials are used, more likely than not, the costs are not being included with other more tangible costs. In addition, it occasionally happens that it is more advantageous for a station to obtain APA equipment, cost free, than it would be to repair equipment, where repairs and spare parts are charged against an allotment. On the other hand, it is one means of tight Bureau control over capital expenditures for equipment even though costs cannot always be readily identified or consistently applied.

Major Non-Recurring Maintenance Program. -- Projects costing under $10,000 will be charged to the local station Maintenance and Operating Allotment, or to overhead in the Naval Industrial Fund as applicable.

Projects costing over $10,000, will be shown on an integrated priority list for anticipated projects for the next two years. These will be complete with justifications, endorsed by fleet commanders, and applicable Public Works Affairs, and will reach the Bureau prior to May. These charges will be against the local facilities allotment or project order established by the Bureau. In Navy Industrial Fund activities if more than half the cost of project is of a military support nature, funds will be alloted against the Military Support Servic es allotment. On the other hand, if more than half the cost is for maintenance of industrial facilities, the entire project will be funded under the Naval Industrial Fund after Bureau's approval is obtained. This

is another instance of unreasonable tight Bureau control over its decentralized industrial activities. In effect, although an activity can effect and pay for its own repairs, approval is still required.

Another significant point is the separate costs of a military support nature which are covered by a separate allotment. This includes military pay, maintenance of quarters, and costs of a non-industrial nature within the command. The unused building ways previously discussed are also considered in this category since they have not been used since World War II. In fiscal year 1956, Military Support Services at the eleven shipyards totalled $21,000,000, or one-third of the combined Maintenance and Operations Allotment for the fleet and shore activities other than shipyards. If the Navy Industrial Fund is to become meaningful, it would appear that this is one item that should be costed into the fund, rather than handled by a separate allotment.

Minor New Construction and Improvement Program. -- In the field of Public Works, there is little doubt that Congress definitely controls the purse strings. The Commanding Officer of an activity is limited to $5,000 for construction and approval projects. While approval is not required, each project, for the coming two years, will be shown on the annual integrated priority list.

Projects costing between $5,000 and $25,000 must be submitted for approval by the Bureau of Ships. Likewise these pro-

jects will be shown on the integrated priority list, and justified for at least two successive years. Emergent projects, which are determined by the Secretary of the Navy or the Secretary of Defense to be urgently required, may be approved by the Secretary of the Navy for amounts up to $200,000.

Public Works is an area which is bound to be restricted for obvious political considerations which are vitallyimportant to Congress. However, the waste, inefficiency and unnecessary extravagance while constructing air bases in North Africa about 1951 contributed much in bringing about these restrictive measures.[14]

It is interesting to note a comparison between the latitude in constructing and repair projects allowed top management in the Navy with the DuPont and General Electric Corporations. While the Chief of the Bureau of Ships is allowed $25,000, Du Pont and General Electric Division Managers are allowed $100,000 and $500,000 respectively for construction projects.[15]

Consideration. -- While many improvements are apparent, one basic step, it would appear, would vastly simplify, shorten, and produce more meaningful budgets. Simply delegate to the three fleet commanders, the task of apportioning funds for activities under their

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14. Notes from Lecture by Mr. W. J. McNeil, Assistant Secretary of Defense, to Navy Comptrollership Class.

15. Notes from Lectures by Mr. A. L. French, Assistant Comptroller Du Pont Co., and Mr. R. L. Knight, General Electric Corporation.

control. Communications and technical assistance from the bureaus would be maintained, but the load would be considerably reduced at each level. This system is used for ship overhauls and has proven very effective, especially from the ship's point of view. It appears that it would be equally desirable for fleet support activities.

CHAPTER III.

OPERATION OF THE NAVAL INDUSTRIAL FUND

General. -- In 1955 Mr. Franke, Assistant Secretary of the Navy (Comptrollership) said, "It must be kept constantly in mind that the installation of the Navy Industrial Fund at industrial and commercial type activities is no guarantee of their successful operation". He may well have had the results of the submarine conversion program between 1952 and 1955 in mind. During this period submarines were being converted from their conventional World War II designs to their high speed, snorkel, streamlined appearance of today. This program was being carried out at the Mare Island, Charleston, and Portsmouth Naval Shipyards, and at the Electric Boat Company, a division of the General Dynamics Corporation, the leading builder of submarines in the United States.

The cost figures produced from the records showed that Mare Island, which at that time was under the appropriation system of accounting, expended 75,000 man days in accomplishing the task. Well behind Mare Island was the Electric Boat Company with 105,000 man days and Charleston, a Navy Industrial Fund Shipyard, with 120,000 man days. Portsmouth, under the appropriation system of accounting, had undisputed claim on last place. On the basis of this fine performance by Mare Island, verified by fiscal and engineering inspection groups from the Electric Boat Company, the con-

tract held by Electric Boat was renegotiated downward.

This illustrates the point Mr. Franke had in mind, that while the double entry accrual system of accounting, utilized by private industry and the Naval Industrial Fund activities, is an effective aid to management, it does not automatically place the activity on a plane with Lincoln Electric Company for efficiency in operations.

However, in 1953, after evaluating the progress made by shipyards under the industrial fund, Secretary Anderson revealed that the Navy fully intended to accelerate its program of converting shipyards to the new system.[16] At that early date, when only three shipyards had been converted for less than a maximum period of eighteen months, it was already readily apparent that the Navy Industrial Fund was far superior to the appropriation system of accounting in this field. This testimony came principally from the Shipyard Commanders who had vigorously opposed the change initially. To-day, two and a half years later, with all shipyards converted, opinion is still the same, but there is also recognition of the fact that there are important areas for refinement. This is not only the opinion of those in the Shipyards and in the Bureau of Ships, but also members of the Cooper Committee Working Group that made a survey of Naval shipyards, Army and Navy Ordnance arsenals,

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16. Hearings Before Sub-Committee No. 3 of the Committee on Armed Services, United States Senate, op. cit., p.77.

Air Force, Army and Navy aircraft engine and motor vehicle maintenance and overhaul facilities in 1954. Listed below are the major advantageous apparent from the use of the Navy Industrial Fund.

Cost Consciousness. -- Probably the most significant change is the increased cost consciousness of all levels of management. This is particularly true at the Charleston Naval Shipyard where standard costs have been installed. However, in 1950, the Navy adopted a long range policy of diverting a large portion ship building and ship repair funds to private shipyards. This also contributed significantly to cost consciousness. During fiscal year 1956 approximately $600,000,000 is being expended for this purpose, even though the Navy's shipyards are operating well below capacity. This policy of maintaining a trained civilian reserve in a declining industry, has driven home a sense of economy in a realistic way. All levels of management and employees realize that people, space, equipment and services must be utilized effectively, and more important, the Navy Industrial Fund is an excellent tool for this purpose.

Product Costs. -- Secondly, it emphasizes end product costs in all transactions. With competition, accurate estimates are a necessity. If, for example, estimates are poor, this will be directly reflected in the financial position of the shipyard. Thus there is an acute awareness of the necessity for realistic

costing of items produced which the Naval Industrial Fund provies.

In the same general area, it pinpoints inefficiencies in a problem area promptly and factually. Practically every shipyard has a Tabulating Section within the Comptroller's Department which provides frequent statements on controllable expenses and productivity that are timely and effective tools of management control.

Other advantages that can be mentioned are:

(1) Cost data produced will produce more accurate budgets.

(2) Provides greater flexibility.

(3) Provides a customer-supplier relationship.

(4) Provides a business type approach to industrial operations.

(5) Provides simplified financing in a single no-year revolving fund.

Disadvantages and Inconsistencies. -- In late 1953, as mentioned previously, two independent groups evaluated and took inventory of the four years spent in implementing Title IV. The first committee under Senator Flanders, examined the extent of implementation while generally accepting the basic structure as sound. The second group under Charles P. Cooper, attacked the problem of analyzing the business structure of the Department of Defense in much the same manner as the Hoover Commission had done for all government agencies previously. It was a thorough analytic appraisal, by capable working groups, at the request of Secretary of Defense Wilson. Many of the recommendations made have already been implemented. Others have been viewed as incompatible with desired

objectives. However, one thing is certain, it was a healthy appraisal, and served as a sound basis for further development. Some of these deficiencies are included in the following list, but all represent the views of so called "Middle Management" at Bureau and field level.

Excluded Costs. -- Under Navy Industrial Fund accounting "Costs" have become an item of consequence. However, in some respects these costs are really not a significant item of management data because of loose estimates and excluded costs which should be included in figuring the cost of the product. The following are a list of the principal "excluded costs":

(1) Free Issue materials, which are bureau controlled, and which have been purchased, paid for, and charged to some appropriation in the past. These could very easily be picked up in the stock fund, and then charged to the appropriation ultimately using them. Under the present system their use permits no sound basis for comparisons.

(2) Military Pay and Allowances are not charged to the costs of the products. As pointed out previously, the pay of all persons directly or indirectly associated with the product should be computed into the cost of that product.

(3) The cost of depreciation should be included as an industrial cost. The Bureau of Ships uses the straight line method of depreciation in its property and plant accounts, but these figures are not included in the costs of the product. The principal

reason for this is the desire for Congressional control.

Congressmen were quick to realize that their control over industrial activities would decrease appreciably if fixed assets were capitalized, and replaced without consulting them. For this reason there is little hope for improvement in this particular area. In passing, it should be noted that other assets in the Navy, such as ships, aircraft, and combat vehicles should not be included in depreciation accounting for the simple reason that they represent combat material.

(4) The final element of "excluded costs" is employee fringe benefits for civilian workers. This represents roughly 3% of wages paid, and are handled by other governmental units. They do not reach the books of the Bureau of Ships at all.

Maintenance Costs. -- Costs related to this subject are not spread over the estimated span between repairs, but are accrued within the fiscal year in which the work is accomplished. This violates the basic accounting principal of recognizing costs in the period which they occur. More important, it is basically unfair to units of the fleet undergoing overhaul during periods of excessive maintenance projects. Through the media of overhead, they assume an unfair burden of maintenance costs. However, in order to correct this situation, additional capitalization will be required. Since the prospects of getting it from Congress are remote, it may be obtained by crediting free materials to the Navy Industrial

Fund Account.[17]

Appropriation Accounting Burden. -- One of the original ideas that led to the Navy Industrial Fund was the many instances of poor management control in using the Appropriation System of Accounting. As practiced now, the Navy Industrial Fund does not supplant the appropriation system of accounting, but is merely superimposed on top of it. This vastly increases the administrative burden requiring shipyards to report status on allotments for the many areas they are issued. Previously mentioned are allotments inthe fields of Minor New Construction and Military Support. These reports, as it is well known, are very rigid as to date of submission, which in turn causes diversion from the principal task of serving the more immediate needs of the Shipyard Commander.

This briefly covers the major advantages and shortcomings of the Navy Industrial Fund. Not all the improvements noted are entirely the result of operations under the Navy Industrial Fund, but unlike the previous system of appropriation accounting, the Fund created the climate and showed the direction. It is with this in mind, that the last and least noticeable contribution is mentioned. It created a sound basis for future development.

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17. Report of the Industrial Activities Working Group, Prepared for advisory Committee on Fiscal Organization and Procedures, Office of the Secretary of Defense, Washington, D.C. July 1954, p. 32.

CHAPTER IV

DEVELOPMENTS IN APPROPRIATION ACCOUNTING SYSTEM

General. -- If any one report were to be selected as having set the objectives for the development of a more effective appropriation accounting system, the logical choice would be the Task Force Report (Appendix F) of the Hoover Commission. This report, prepared in 1948, has set not only the objectives to be achieved, but also the general pattern necessary for the orderly evolutionary change in the appropriation structure. Implementation of all the features recommended would be nothing less than a miracle. Adoptions of some features are unrealistic in that they fail to recognize the rights and privileges of Congress. Still others would prove impractical in that they would be expensive and not actually necessary in the numerous small stations.

With these ideas in mind, this rather lengthy excerpt on the advantages of accrual accounting is presented:[18]

> BASIS OF ACCOUNTING. - Next in importance to the establishment of an appropriate accounting system and the responsibility therefor is determination of the basis upon which the Government's accounts shall be kept.
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> There are two bases of accounting. One is the cash basis, the other the accrual basis. The cash basis amounts to little more than the recording of receipts and disbursements. When used in the keeping of governmental books, the cash basis produces little more than an account of revenues collected and money paid out.
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> Under the accrual basis, income is taken into account when it is earned, and expenditures are taken

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18.Task Force Report (App. F) Prepared for the Commission on Organization of the Executive Branch of the Government, January, 1949, pp. 102-4, T. Coleman Andrews and others

into account when they are made. Thus, to state it simply, when the accrual basis is used in governmental accounting, revenues are taken into account and put under control when they are assessed for formally established, controls of expendable supplies, and the investment therein are maintained, and expenses are taken into account as they are incurred. On the budgetary side, the accrual basis affords full current information concerning the realization of the revenue estimates and the expenditure and availability of appropriations.

In government, control of appropriations is especially important. In order to control the use and prevent over-expenditure of appropriations, it is necessary that the available balance of each account be known at all times. The available balance of an appropriation is the difference between the amount appropriated and the sum of the amounts already withdrawn and the amounts that will be withdrawn from it in settlement of expenditures that have not yet reached the disbursement stage.

Thus, in budgetary accounting, expenditure occurs when a commitment to buy is made, and it is imperative that appropriation accounts be charged at this time.

If something purchased is not immediately consumed, further accounting becomes necessary. To illustrate, if a commitment is made to purchase supplies that may last for considerable time, expense is not incurred at the time the supplies are received, but later, as they are consumed.

Thus, accounting for expenditures of appropriations is one thing, and accounting for incurrence of expenses is another. But, both are necessary, the former to control the consumption of appropriations, the latter to control, among other things, the evil of year end rushing to spend surplus balances of appropriations and the investment in supply inventories as well.

Refinements of accounting such as have been explained are not afforded by the cash basis of accounting. The Government's accounting is a mixture of the cash basis and the accrual basis, but it does not include supply accounting.

We think it obvious that a basis of accounting that never shows the Government's true revenues and expenses for any year, and that does not provide proitive control of assets, liabilities, and appropriations is thoroughly inappropriate for the Government's needs. We suggest, therefore, that the cash basis of accounting be completely ruled out, and that the accrual basis be adopted for all of the Government's accounting.

In progressing toward this objective, the Navy has taken two significant steps. The Navy Industrial Fund with the double-entry accounting maintained on an accrual basis has been adopted, as we well know, for the large industrial units. In the second area, it has streamlined its appropriation system by going to the Program Budget, while reducing the total number of appropriations from 48 to 21, as previously noted. This gives the Bureau of Ships an allocation of three appropriations:

(1) Ships and Facilities, Navy

(2) Construction of Ships, Navy

(3) Shipbuilding and Conversion, Navy.

The Cooper Committee in their report recommended reductions in the number of appropriations to five for each Service. These categories of expenditures are:[19]

(1) Military Personnel

(2) Maintenance and Operations

(3) Procurement and Production

(4) Research and Development

(5) Construction

This would not radically upset the existing budgetary structure for field and fleet activities under the Bureau of Ships management control. The "Facilities" appropriation would

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19. Financial Management in the Department of Defense, Advisory Committee on Fiscal Organization and Procedures, Office of the Secretary of Sefense, Washington, D.C., October 1954, p.11.

be discontinued, and in its place, "Maintenance and Operations" would be the annual appropriation for items required for maintenance and operations. The other category of expenditure, "Procurement and Production," a no-year appropriation, would cover long lead time items such as Plant Equipment and Construction. Note that this plan does not pattern itself to individual bureau control of appropriations, which, in effect, would pass financial control one level higher. Without speculating, it is not difficult to visualize the increasingly important role the Navy Comptroller may play in the future whether or not these recommendations are implemented.

One point, however, appears clear. The direction of change is definitely in the direction recommended by the Hoover Committee, towards a sound accounting structure employing the accrual basis. This coupled with an improved budgetary structure, should do much toward putting the Navy on a sound financial basis.

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